

97-84045-10

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The business of suretyship

[n.p.]

[1920]

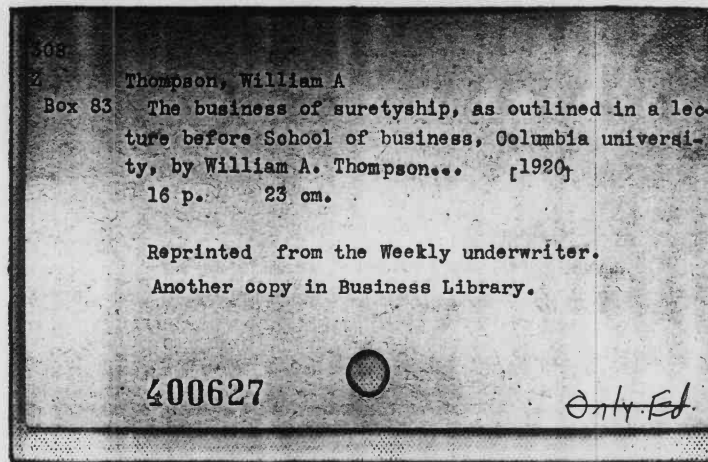
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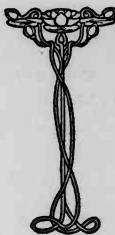
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The Business of Suretyship



As outlined in a lecture before
School of Business, Columbia University

By

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The Business of Suretyship

Reprinted from
The Weekly Underwriter



18 June 1920 JmW

THE BUSINESS OF SURETYSHIP

Coverage Offered—Different Types of Bonds—Requirements
of Bonding—What Different Forms Include—
Future of Business

A Lecture at School of Business, Columbia University
By WILLIAM A. THOMPSON, Vice-President of
the National Surety Company

The business of writing surety and fidelity bonds, although classified as insurance by the legislature, and supervised by the insurance department of the State of New York and of other states, is not insurance, strictly speaking. It is similar to insurance, and the business is conducted in many respects in like fashion, but it is not, like insurance, based on co-operation to distribute loss, but rather on credit and accommodation. A striking difference between them is seen when we note the parties interested in the two contracts. Insurance as a contract contemplates two parties only—the insured and the insurer; while suretyship has to do with the relations between three parties—the primary debtor, who is the principal on the bond; his surety, corresponding to the insurer; and the obligee, corresponding to the insured.

In insurance, when a loss is paid to the insured, the insurer has no one to look to for reimbursement, while when a surety company pays a loss to the obligee it is entitled to full recovery from the principal on the bond. Another material difference is that while, in insurance, the insured and insurer may cancel their contract, by mutual agreement, this cannot be done by the surety and its customer—principal on the bond—for a third party, the obligee, has a property right in the bond after its delivery which cannot be taken from him, without his consent or without due process of law. Still another distinction between suretyship and insurance is seen in the relation between the premium for the risk and the liability assumed. The agreed premium is the compensation and consideration for a policy of insurance. If the insured fails to pay the premium there is no consideration and the contract cannot be enforced. In suretyship the bond is valid and enforceable, after execution and delivery, whether or not the premium has been paid. This rule would not apply in suretyship, however, in those cases where the obligee himself agrees to pay the premium. He could not recover if he had failed to meet his contract.

DEFINITION OF A BOND

A bond is an obligation in writing and under seal and has been called the most sacred instrument known to the law. It is a deed or obligation whereby the obligor obliges himself, his heirs, executors and administrators to pay a certain sum of money at a day appointed; generally conditioned, however, that if the obligor does some particular act, the obligation shall be void. A bond may be given by the principal debtor alone, but we are now considering only those bonds where the prin-

principal has joined with him a surety to guarantee his obligation. A surety is one who becomes responsible for the debt, obligation or conduct of another. The surety is primarily liable for and with his principal, and his obligation does not require that the obligee first exhaust his remedies against the principal debtor. In this a surety differs from a guarantor, pure and simple, who is answerable only when the creditor or obligee has diligently pursued the principal without result.

The giving of surety bonds has shown a manifold increase since corporations were formed to act as surety for hire. For many centuries personal suretyship was the only form known to the law and to business, but it was never wholly satisfactory, because it happened frequently that individuals acting as surety without any compensation whatever, would, by the default of some friend or acquaintance, be plunged into financial disaster and ruin; or again, when such a default occurred it would be found that the surety as well as the principal was unable to meet the financial obligation and so the obligee was without any real protection, and deprived of his just dues.

Moreover, as a practical matter, a personal surety of means and business responsibility found it increasingly inconvenient for him to drop his own affairs and attend at court, for instance, in order to qualify as surety for his friend by proving his financial worth; and the principal who had been served by his friend as surety would find that even if the obligation for which his friend became his surety was discharged, the latter would still consider that the principal on the bond was under obligation to him, and such dealings became more and more a matter of embarrassment. These things continue to be reasons against personal suretyship as they were, about fifty years ago, reasons for the organization and incorporation of the surety company. Someone saw a field for giving bonds for a stipulated fee at a rate sufficient to pay losses and expenses and make some profit, and thus relieve those who were obliged to give bonds, when they had met the condition of the bond, from all obligation to their bondsmen.

GROWTH OF SURETYSHIP

Personal suretyship is mentioned in the first book of the Bible. It is probably as old an instrument of business as there is, and as well known, thanks partly to the classical matching of wits between Portia and Shylock, but since the formation of surety companies in the last half century the business of suretyship has increased by leaps and bounds, and while personal suretyship survives in certain sections of the country to a greater degree than in others, the superior advantages of corporate suretyship from every standpoint are becoming more widely known and better understood each year and crowding out the old form of individual suretyship.

Surety companies today are writing over a million bonds each year, with a premium income of more than fifty million dollars, and assuming annually an aggregate amount of liability in excess of five billion dollars. The combined capital and surplus of the surety companies doing business with the United States Government and subject to the supervision of the treasury de-

partment is today over sixty-six million dollars. Their total resources in cash, securities and real estate, in the aggregate, approximate one hundred and fifty million dollars. In addition to this, there are other surety companies not holding certificates of authority from the treasury department, and every once in a while we hear of the formation of a new company to undertake this business.

WRITING RULES

Here it would be *apropos* to refer to a rule of the United States Treasury Department and the insurance departments of various states that no surety company can execute any one bond for a larger amount of actual liability than ten (10%) per cent of its capital and surplus. This rule has been in effect for some years, and has proved to be of great value to the surety-using public as well as to the companies themselves and to their stockholders, as one more safeguard against over-enthusiasm or recklessness in underwriting. This does not mean that a company cannot write a bond for more than ten (10%) per cent of its capital and surplus, but that if it does, it must have the excess over such percentage satisfactorily covered by reinsurance, collateral or otherwise.

Despite the inherent difference between suretyship and insurance, it has been found to be instructive and advantageous to base premium charges for bonds, in part at least, upon actuarial experience. Records of this experience are not as complete and perfect as could be desired, owing to the comparatively brief period open to consideration, to the failure of many companies in the past, and the fact that several of the companies had not until quite recently segregated the necessary data in their bookkeeping systems. Rates vary with the class of bond, and the nature and extent of hazard, and in some classes the rate is reduced as the amount of bond increases.

HOW RATES ARE SET

Depending upon the actual liability under the bond, the rates will run all the way from one dollar per thousand of the penalty of the bond to twenty dollars per thousand on the bond or even on the amount of the contract secured by the bond. The different rates are well established and in many instances have had the approval of the state insurance departments and of the United States Treasury Department. The rates I have referred to are minimum rates, but it occasionally happens that a surety company will be disposed to take an otherwise doubtful or sub-standard risk upon the payment of a larger rate of premium. In this connection I recently heard of an amusing incident where an agent of a certain company—somewhat of a Shylock himself—in presenting a case said to the underwriter: "This applicant is a very good friend of mine, can't we charge him double rates?"

DIVISIONS OF RISKS

There are three broad divisions of the risks written by surety companies, namely, fidelity bonds, court bonds and contract bonds. The dividing lines are not always easily discernible, for through each class and each of their sub-divisions run the moral risk and the financial risk in greater or less degree. In each of these three large classes we constantly find bonds which

might as readily be classified under one of the others. Nevertheless, in general the three may be defined. Fidelity bonds guarantee the honesty of employees. Contract bonds guarantee the performance of contracts. Court bonds are bonds required or permitted to be filed in actions or proceedings at law.

Perhaps the first legislation for the incorporation of surety companies was that passed by the State of New York in the year 1865, authorizing the formation of companies to guarantee the fidelity of persons holding places of public or private trust. As far as we can definitely ascertain, however, the first American surety company was formed some ten years later and did not begin business until 1879. Its business, and that of a Canadian company started somewhat earlier, was for some time limited to fidelity bonds.

This division of the business is accordingly the oldest, as it is also the largest in point of the number of bonds written. The simplest form of fidelity bond guarantees the employer against loss on account of the dishonesty of his employees. There are, however, many different forms of fidelity bonds carrying greater or less hazard, as the employer may require and the underwriting conditions permit; and of late years surety companies have issued new kinds of protection, essentially fidelity bonds, but including much wider hazards. We will later refer to one or two of the more important of these recent developments in this class.

WRITING CONSIDERATIONS

In general, underwriting of fidelity bonds must primarily consider—first, the temptation to which the employee will be exposed in the position in which he is to be bonded; and, second, what his record and reputation has been prior to his application for the bond. The experience of surety companies is evidence of the fact that the normal human being, at least those who are placed in positions of trust where bonding is a business essential, are in the main honest, and unless confronted with or led by some strong temptation are not likely to steal from their employers.

There are, however, some temptations that appear to be more difficult for the trusted employee to resist than others, and among them may be mentioned inadequate compensation, lax business method or system in the office of the employer, and particularly lack of supervision and audit. The amount of money he handles and the extent of his sole control over the money he handles must be considered. A special class of employee peculiarly open to temptation is the foreign agent or representative, or indeed any employee, whose duties must be performed at a great distance from his head office.

INVESTIGATION OF APPLICANT

The employee's past history should be given the most careful examination and his statements in regard to it thoroughly checked up before issuing his bond. As has been well said, it is as important to the underwriting of a fidelity bond that the applicant's intellect and morals be examined, as it is that the heart and liver of an applicant for life insurance be examined, and the fidelity examiner's task is the more difficult. A doctor by brief and simple examination can tell to a certainty whether

a man's heart beats true, but there is no such short test that will suffice to show the strength of a man's moral fibre. The best a surety company can do in the way of judging the character of an applicant is to see how he has conducted himself in the past and what reputation he has made with unprejudiced persons who have known him well.

Applicants for fidelity bonds must disclose to the surety company with exactitude where they have been employed during the preceding ten years and the name of each employer during that period. An inquiry is then made of each of his employers to check up his statements, and to learn their experience with and opinion of the employee. The applicant must give the names of a number of references, and to each of these the company sends an inquiry, with searching questions on a blank form, concerning the character and habits of the applicant, and unless replies are received to these inquiries, and are satisfactory, the applicant's bond is declined at once, or some other form of investigation is made by professional investigator or detective to cover any doubtful point or incident.

If it is learned that the applicant has made a habit of drinking, gambling, speculating, or extravagance, the company would be loath to issue a bond for him. Those who have been convicted of crime or of serious breaches of the moral law are not proper subjects for fidelity bonding. The applicant's age must be considered; and the extent and kind of his property holdings; the length of his employment; whether he is married and if he has children; his experience in the particular business; his education in many cases; and the race to which he belongs; all must be considered and weighed by the underwriter before passing upon a fidelity risk.

In last month's *American Magazine* there appeared an article by President William B. Joyce, of the National Surety Company, on the subject of "Human Beings who are Good Risks and Poor Ones," which is perhaps the most interesting story of the fidelity bond that has been written, and because of that writer's long and successful experience, and his eminence in the surety world, I may be permitted to read from his article. [Quotations omitted for sake of brevity.]

There are two kinds of the ordinary fidelity bonds. One is a separate bond covering a particular individual in a given amount, and the other is a schedule bond under which any number of employees may be covered, and on the latter form a list is attached to the bond and made part of it giving the employees' names, positions and the amount for which each is covered. The schedule bond may be changed from time to time by means of what are called change notices whereby the employer asks the surety company to add or deduct names from the list on a special form prepared for that purpose and furnished by the company. The majority of the big mercantile houses, railroads and other large business concerns carry schedule bonds, the largest of which now in effect covers approximately thirty-four thousand people. The largest fidelity schedule ever written was for the American Red Cross, amounting in gross liability to thirty-five million dollars. This was written

by the National Surety Company during the war for a premium which that company promptly donated to the Red Cross War Fund.

It would be well to mention two new classes which carry the fidelity risk, but are recent and somewhat intricate developments of this kind of business.

BROKERS' BLANKET BONDS

The newspapers have apparently considered, of recent weeks, that outside of Republican primary politics, after-the-war reconstructions, and the Mexican situation, nothing is more interesting than the search for "Nicky" Arnstein, and the daily press has been full of stories telling of the large losses that bankers and brokers and the surety companies have suffered through thefts by or from messengers. While the losses of the brokers have been very large, no one surety company has lost as much as might have appeared from a casual and hurried reading of these stories. This is due to the facts that not all of the brokers' losses were covered by blanket bonds and that this particular kind of bond has been re-insured very generally by the executing surety company in almost every case. Blanket bonds, which have been brought so prominently before the public by the recent losses mentioned, protect the banker and the stockbroker:

1. Against any dishonest act of any of their employees wherever committed and whether committed directly or by collusion with others.

2. Against robbery, burglary, theft, hold-up, destruction, or misplacement of money or securities while in any of their offices covered under the bond, whether effected with or without violence or with or without negligence on the part of any of the employees.

3. Against robbery, hold-up, or theft by any person whomsoever while the property is in transit within twenty miles of any of the offices covered under the bond and the custody of any of its employees, or against negligence on the part of any of the employees having custody of the property while in transit.

This blanket bond has been sold by some of the surety companies—extended and broadened, from time to time—for a period of about five years. It is the most adequate protection that has ever been offered to financial institutions and dealers in negotiable securities, and protects them from all manner and possibility of loss for the dishonesty of anyone connected with the insured, from the head of the house to the office boy, as well as protecting them against the dishonest or criminal actions of outsiders. The Lloyd's underwriters of London had been issuing somewhat similar security for some years prior to 1915, but American business men preferred to have their surety, fidelity and burglary insurance dealings with American companies.

It is perhaps difficult to determine even now whether this class of bond in its present form will prove to be profitable at the current rates of premiums, but the coverage is so valuable to bankers and brokers that undoubtedly the blanket bond will be continued in substantially the same form by some of the

companies, even though experience should make imperative the increasing of the rate.

CONVERSION BONDS

One other form of suretyship kindred to fidelity bonds, which, although new, has begun to assume considerable proportions, is that which may be called conversion bonds. So far these bonds have been largely limited to protection against conversion of automobiles, and run in favor of banks and others loaning money to dealers and purchasers of cars. The first conversion bonds issued by surety companies were written in the early part of 1917. Prior to that time this coverage had been given by fire companies in their automobile policies. Decisions of the Supreme Courts of the States of California and Ohio prohibited fire companies from continuing to give this form of coverage, because their charter did not provide authority to do so. The National Surety Company then, immediately issued this form of coverage so that the insuring public would still be able to get the benefit of this necessary protection.

These bonds are issued in favor of the finance companies, protecting them against the fraudulent mortgaging, pledging, converting, or otherwise fraudulently disposing of motor vehicles or the proceeds thereof by the dealer covered in the bond.

Where this form of coverage is issued covering an individual purchaser, the bond may then run in favor of a dealer, the bank or a finance company. Then the coverage afforded the holder of the bond is against the absconding with, or fraudulent selling or mortgaging of automobiles before the final payment of the notes given by the purchaser.

SOME REQUIREMENTS

Where we issue a bond covering the dealer as principal, we require them to complete a detailed financial statement and application form, which is thoroughly investigated and a line of credit established. In addition to this, we require the finance company or bank to make an independent thorough investigation and submit their entire file to us. We require the obligee to make frequent examinations of the cars which are in the possession of the dealer—this is done to eliminate losses extending over a period of time.

In the case of the purchaser's bonds, we do not require the purchaser to complete an application, but rely entirely upon the investigation of the obligee, and to that end we thoroughly investigate the personnel and the methods of the obligee in passing upon credits, and if satisfied in those respects, we approve the bonds.

Since we have written this business our loss ratio has been in excess of the normal loss ratio, but this may be attributable to our inexperience, and we anticipate with the experience thus gained, during the past five years, the near future will show a favorable measure of profit, through improved underwriting or an increase in rate.

It might be well to point out that the automobile insurance has developed a new institution—the Automobile Finance Company. Banks are reluctant to go into this business on a large

scale on account of the detail involved. Therefore, these finance companies were established and they make their profit—first, upon the legal rate of interest; second, upon the service fee that they charge, and third, from the insurance, because they require certain forms of insurance to be taken out in their interest and paid for by the dealer or purchaser. By reason of the large volume of insurance that they control, they are able to secure lower rates from the companies covering fire and theft hazards. They charge the purchaser only the prevailing rate that the purchaser would be obliged to pay if they were to obtain a policy direct—but it gives a substantial margin of profit to the finance company.

PUBLIC OFFICIAL BONDS

A very large and important class of fidelity bonds is that which includes bonds given for public officials. These are bonds required by law to be given by persons holding positions of public trust and are conditioned for the faithful performance of duty and the accounting for all moneys coming into their hands, according to law. The officials from whom such bonds are most generally demanded are treasurers, tax collectors and sheriffs. Very much of the same sort of investigation of the applicant must be made, as in the case of the ordinary fidelity bond.

Underwriters must bear in mind that the applicant has usually just gone through an election campaign and if his past contained anything likely to show him to be a poor risk the white light of publicity would have disclosed it. The applicant for such a bond is likely to have more financial responsibility than the applicant for the ordinary fidelity bond. On the other hand, the form of bond for the public official is more hazardous than the ordinary employee's bond, because of the statutory requirements to account and pay over.

Nearly all public official bonds involve a liability not only for the honest handling of the funds actually received by the official but also for all funds which he should have collected. Under most of these bonds an official would be liable for the loss of the money by failure of the bank in which he deposited it during his term of office, and also he would be accountable for its loss by any act of his deputies. The surety company generally demands that these hazards be minimized by requiring a bond from the depository and a bond from the deputy.

COURT BONDS

We have already seen that court bonds include such bonds as are required or permitted by law to be filed in proceedings or actions in court. In considering this great class of bonds it is peculiarly apparent that suretyship is a business of accommodation rather than of loss distribution. Court bonds are sub-divided into two divisions, one of which may be called fiduciary bonds, and the other financial guarantees. In both sub-divisions the underwriting rule of full protection to the surety is generally maintained, on the theory that the surety company should take no risk, but base its business on the pledging of credit as an accommodation to its principal, and charge its premium for the service rendered.

Ideal underwriting of court bonds in particular presumes full security. This applies more emphatically to the financial guarantee. The surety company loans its credit just as the bank loans its money, although for one or two per cent of the risk, instead of at the bank rate of six per cent. Just as banks require marketable collateral or satisfactory endorsers as security for the payment of their loans when due, so surety companies when guaranteeing a principal's debt rather than his conduct, secure themselves against loss by insisting on good collateral or reliable third party indemnity. The giving of the bond enables the principal for the duration of the bond to withhold the money he would be obliged to pay or deposit, and permits him to use his money in his business or other affairs.

This form of suretyship and the many and various direct financial guarantees classified as contract bonds assume that each principal will meet his obligation when due, and that no losses will occur. In actual practice, however, losses on such bonds are by no means uncommon, for underwriters are not infallible in their judgment of the reliability and future financial responsibility of the principal and his indemnitor, or of the permanent value and marketability of the collateral upon which rests their approval of risks.

Nor can underwriters always foresee every hazard in each bond they consider. The best underwriter I know says it is the unknown hazard that he fears. Therefore, the surety underwriter of financial guarantees should constantly keep fresh in his mind the rule that he is conducting purely an accommodation business.

ADMIRALTY BONDS

One of the most interesting lines of court bonds of late years has been that of admiralty bonds. These are bonds given for ships, or their owners; or those that go down to sea in them. The most common form of such bonds are bonds for the release of the ship when she has been seized under a libel on account of a collision; or on account of damage to her cargo; or for salvage, on the libel of another ship who claims to have salvaged her or her cargo; or for or on account of some breach of charter on the part of her owner.

When the libel is filed a United States Marshal is placed on board of the ship and she cannot sail or even unload without giving bond. There have been a great many of these bonds given in recent years, and during the war they were especially large in size on account of the high value of tonnage. On this point I might say that the company I represent, and at least one other company organized in this country, are rapidly extending their business abroad through foreign banks or other mediums, and this has been of particular service to American shipowners and consignors of cargo, and generally to exporters and importers and all houses doing an international business.

SOME DIFFERENT FORMS

Included in the sub-division of court bonds, which are underwritten practically along banking lines, are a score or more of different kinds of bonds and undertakings. There are bonds of this kind for plaintiffs as well as for defendants. The

bonds are conditioned for the payment of damages, the return of property, or the payment of judgments. There are undertakings to pay costs required from non-residents; on attachment, injunction, or order of arrest, to pay damages in the event that the court finally determines that the plaintiff is not entitled to the relief the bond permits him to obtain; replevin bonds and re-delivery bonds involving the production of a particular piece of personal property in the event the court determines against the principal on the bond.

There are appeal bonds, bonds to discharge attachments, and bonds to release mechanics' liens, all of which guarantee to pay judgments against the principal, and there are a score of other bonds of like character which the time permitted for this lecture would not permit of describing in any detail.

Bail bonds have in the last six or eight years become an appreciable part of the business of surety companies and, being forfeitable, must be underwritten in a good deal the same way as financial guarantees, although they are strictly a contingent liability and are cancelled by the appearance of the defendant. The charge against the defendant is a very material part of the risk on a bail bond, so that all bail bonds of the same size do not carry the same degree of hazard.

It is interesting to note that the leading surety companies during the war and since then have almost invariably refrained from executing bonds for defendants accused of crimes which may be classed as unpatriotic, such as anarchy, treason, sedition, etc. The wise surety companies also avoid writing bail bonds in vicious or malodorous cases even though they are fully secured.

The entry of the surety companies into the bail bond field has turned out to be of advantage not only to defendants who are principals on the bonds, but to the courts and to the state, because surety company bonds have now driven out of the field most of the straw-bondsmen who caused the authorities so much trouble and loss in years gone by.

OTHER COURT BONDS

Fiduciaries, so-called, are appointed by will or deed or by order of court to handle and to account for trust funds. In this sub-division are included bonds for executors, administrators of all kinds, trustees, guardians of infants, committees of incompetent persons, and many others, whose duties are similar but differently named, as well as for receivers and trustees in bankruptcy, and receivers and assignees in other litigation or proceedings. These bonds almost invariably are conditioned for the performance of the duties of the fiduciary, as set forth in some statute or in the will or deed or order, which is the medium of their appointment. For their legal discharge from their duties and for cancellation of liability on the surety's bond, an account to the court is almost invariably necessary. On such an account a decree is made for the final distribution of the fund, and the termination of liability on the bond.

For a good many years the unusual underwriting of fiduciary bonds has meant joint control of the assets of the estate by the surety with the principal. This is almost invariably the rule in New York, and it is spreading rapidly elsewhere as the pub-

lic is educated to appreciate that far from being a bother and trouble to the fiduciary and his lawyer and to the beneficiaries, joint control really is a help and benefit to all concerned, and it is confidently asserted that the combination of an individual fiduciary, long intimate with the affairs of an estate and a family, together with a sound surety company, at least equals in efficiency and safety in the management of a trust fund, the appointment of a corporate fiduciary which eliminates the personal element entirely. The surety company co-operates with its principals, does not interfere with their sound discretion, but on the contrary aids and guarantees the performance of their frequently perplexing duties.

WHAT JOINT CONTROL MEANS

Joint control in its actual workings is a simple thing, but requires great and constant care. It means that the cash in the trust fund or estate shall be placed in a bank in the name of the fiduciary and not to be withdrawn without the written consent or counter-signature of the surety; and that the securities of the fund are to be placed in a safe deposit box which shall not be opened by the principal except with a representative of the surety present.

This method of protection has undoubtedly saved surety companies and the estates they have bonded millions of dollars. It must be thorough in its working or it is of little use. I recall a case of a man who was appointed guardian of his daughter to take care of a fund of sixteen thousand dollars recovered in an action brought for personal injuries to her on account of loss of a leg. The guardian had succeeded to his father's business when it was rated at ten to twenty thousand dollars and had built it up until it was rated fifty to seventy-five thousand dollars. To all intents and purposes, outside of his business, he was a man of domestic habits, a good husband and father.

Such dealings as the surety company had had with him during a number of years had indicated apparently beyond question that he was a man of his word and could be relied upon. Twelve thousand dollars of the estate was invested in bond and mortgage. The time came for the mortgage to be paid off. He called for the papers. They were taken out of the safe deposit box and because of his reliability given to him for the purpose of collecting and receiving payment on the mortgage. All would have been well for the surety company had a proper note been made and the matter followed up promptly in order that the proceeds of the mortgage could be placed under counter-signatures.

This was not done and several months later when the surety company awoke to the fact that he had not returned the mortgage or accounted for its proceeds, it was discovered that he had invested the entire twelve thousand dollars in the capital stock of a company owning a beauty parlor in which a lady of no particular virtue who turned out to be a close friend of his was the chief person interested. The surety company's loss and expense, before it finally had to make payment to the new

guardian who was appointed, was in the neighborhood of fifteen thousand dollars.

Joint control in New York and many of the states has express statutory authority, and if all the assets are of a nature which will permit joint control, and it is carefully maintained, no loss should occur. In every fiduciary case, and especially in those where the surety is asked to waive joint control, the underwriter should know the term or duration of the risk; the nature, amount and location of the assets; the financial resources, business ability and reputation of the applicant; names and addresses of beneficiaries; who are creditors and the amounts of their claims; and should have a copy of the will, deed or order under which the fiduciary will act in order to know what his duties are and the width of discretion given him.

FEATURES OF CONTRACT BONDS

Contract bonds are given to secure the faithful performance of contracts. They cover the entire range of contractual relations. Perhaps the best known forms of contract bonds are those guaranteeing construction of buildings, roads, sewers and similar projects, bonds guaranteeing the furnishing of materials and bonds guaranteeing the maintenance of the condition of the work for a specified period after its completion. The records of our company contain bonds on contracts ranging from a structure costing a few hundred dollars to engineering projects of many millions.

The Shandaken Tunnel now under construction as part of the New York City water supply system is under a bond. That work will cost about twelve million dollars and require four years to complete. The City of San Francisco is about to let a contract for the Hetch-Hetchy Dam to cost something over five million dollars and the City of Newark has been seeking bids for the Wanague Dam, estimated to cost five million dollars.

Shipyards and training camps constructed during the war were covered by surety bonds and advances of money made to contractors and manufacturers were given under surety bonds guaranteeing the return of the funds. Some of these bonds were in very large amounts. Several of the states are at present engaged in letting large contracts for the construction and repairing of roads.

For contracts such as these, the principal underwriting features to be considered are the amount of the contract and the amount of the bond as compared with the financial resources of the contractor and the amount of the other work he has on hand. The underwriter must also consider the comparative amounts of the bids of other contractors, and the experience of the contractor in the particular line of work for which he asks a bond and his general reputation, and whether he has made arrangements for material and secured sub-contracts.

General conditions, such as the tightness of the money market, or the supply and the price of materials and labor frequently are most important in the consideration of construction

contracts particularly. It is always advisable to verify the financial statement submitted by an applicant for a contract bond, and to know the value and marketability of all of the assets he lists in his statement. Maintenance bonds are especially hazardous because of the length of time generally attached to such guarantees.

OTHER CONTRACT BONDS

Bonds required of holders of licenses under certain city ordinances are classified as contract bonds. We bond junk dealers, second-hand dealers, pawnbrokers, plumbers, handlers of explosives, and innumerable other licensees. Recently there has been a large volume of bonds for manufacturers and dealers in non-beverage alcohol. Under the head of contract bonds also come bonds given by members of trades associations guaranteeing their compliance with the rules of the association, and in the Tidewater Coal Exchange, just formed, bonds are required from the different members to cover payment of balances due the other members on their clearings.

Lease bonds guaranteeing the payment of rent, and, in a newer form, guaranteeing the completion of a building, or of alterations in a building, free of liens, are more and more in demand.

A BUSINESS OF VARIETY

One of the many fine things about the surety business is that those engaged in it are brought in contact with every other line of business or profession. It is a business of infinite variety. Suretyship runs the whole gamut of business. It guarantees the honesty of the treasurer of the Clergymen's Retiring Fund Society of the Protestant Episcopal Church in the United States of America, and it guarantees the performance of a contract to remove all the dead clams from the beaches in the City of New York. People die—consequently administrator's and executor's bonds are required. People in positions of trust are required to give fidelity bonds; contractors are required to give bonds for the completion of their contracts; manufacturers for the delivery of goods. Lawyers need bonds for their clients.

As an example of the variety of the business let us note some of the ways in which the surety company is called upon to serve in connection with a ship. A bond is written covering a contract for the construction of a shipyard; others for the building of ships—steel, concrete and wood—and for war vessels as well as for merchant vessels; still another covering advance payment on a contract for a ship guaranteeing that money advanced will go into the work or be returned; a bond guaranteeing that the ship will reach a certain speed on her trials; guaranteeing a charter party which corresponds to the lease of a house; when government owned, a bond for the managers or operators of the ship; a bond guaranteeing the payment of freights and even guaranteeing the payment of premiums for marine insurance; guaranteeing the delivery of a certain cargo; protecting the ship and its owners or charterers against delivery of cargo when a bill of lading is lost; release of the ship from a libel in court on account of a number of

causes; and bonds permitting the release of cargo pending a general average adjustment. Similar lists of bonds could readily be made showing how surety companies serve many other business interests in manifold ways and how suretyship is being woven closer and closer into the fabric of business and commerce.

SOME OTHER LINES

There are some lines of business, however, that are not so well known. For instance: Automobile Tires—Many people, particularly users of tires, do not know that it is possible to secure a "life insurance" policy on their tires. Manufacturers issue these guarantees, but, unfortunately, they do not always fulfill them. Hence the demand, by users of a guarantee, for a surety bond which will guarantee that the tire will deliver a certain mileage providing it is not damaged through accident, neglect or abuse. These guarantees are attached to each tire. The guarantees are printed on a tag which is securely fastened to the tire by a steel wire and sealed with a lead disc.

Guarantee of Trees.—Another rather unusual bond is to guarantee that trees will grow. It would appear that nothing would be more natural than that trees should grow, but frequently they do not. They may be damaged in transplanting. Droughts may ensue. Trees may not be taken care of properly and occasionally we have demand for such guarantees—generally in connection with fruit and nut orchards or in connection with the beautification of some rich man's summer home.

Lightning Rods.—Most of us have heard of the "slick lightning rod agent," but many of us have not heard of the latest developments in connection with their sale—particularly in farming sections. The farmer, having been "stung" so frequently, now requires guarantees that the rods will carry the electricity to the ground without damaging the building. Some manufacturers even undertake to protect him against any loss in the event that their rods fail to fulfill their guarantee. Other manufacturers are more canny, and simply guarantee to refund the cost of or to repay the cost of rodding the building or to make repairs, whichever is the less.

Blue Sky Laws.—There have been many adroit schemes devised to separate people from their wealth. One of the schemes that is worked most easily and profitably is the old stock selling scheme. People capitalize the air, the water and the oil in the earth—anything that occurs to them. They start out to sell the stock to the unsuspecting public. A glittering prospectus is issued, and if only a portion of the statements are believed, large sales result with correspondingly large profits—and it has become necessary for the government to protect the public, as far as possible, against misrepresentation and fraud. Most states now have Blue Sky Laws which require stock-promoters, stock-jobbers, stock-salesmen, and others, to secure licenses before selling stock to the public, which means, of course, that they must explain their plan to some state official, secure his approval and give bond. This prevents many losses, but, alas, many "wild cats" are still sold to the unsuspecting public.

Co-operative Apartments.—A very modern development is

the use of bonds in connection with co-operative apartments. The leasing situation in Greater New York is known to all of you, but some of you may not know the use of surety bonds in connection with solving some of these problems. For instance, the tenants form a corporation. The receiver of subscriptions is bonded. The contractor for the erection of the building is bonded. The subscriptions to stock or for apartments by the tenants are guaranteed and even the tenants may be required to guarantee that they will pay the rent agreed upon.

THE FORGERY BOND

An interesting addition to the business of surety companies is the forgery bond, a form of coverage initiated during the past year and which has been adopted by several of the surety companies, and which, although called a bond and in the form of a bond, is really insurance.

For many years there have been on the market various makes of machines which have been sold to business houses and banks to protect their checks. Nine business houses out of ten are using some form or another of check protection and several thousand men earn their livelihood by selling these various makes of machines throughout the United States. These machines are primarily designed to prevent the raising of the amount for which a check was originally drawn, and each machine manufacturer claims that his machine is the superior machine on the market. All that is claimed by the manufacturer for his machine is that it renders practically impossible the raising of a check.

In a recent issue of the *Saturday Evening Post*, you will find an article entitled "Your Check," proving that skillful check raisers can and do "beat" the machines. There are so many other ways, however, of causing losses through the manipulation of checks by the criminal class, that protection of the amount line of the check is not regarded as sufficient. Therefore, the forgery bond is so drawn that it secures the drawer of the check, and his bank or banks, against any loss that can happen to him or them because of any alteration of date, number, change in the payee's name, raising the amount of the check, forging of signature or forging of endorsement. It is the only complete coverage, and covers both the face and the back of the check which no machine can possibly do.

A recent incident which the *Post* article does not mention and which was called to our attention by the office of the Post Office Inspector in the New York post office, involved the official check of Sing Sing Prison, which, as I recall it, was drawn for something in excess of two hundred dollars in favor of "Myrick Co.," and signed by Warden Moyer and made payable on either the Highland State Bank of Highland Falls or the Mechanics and Metals National Bank of New York. This check was sent through the mails and was abstracted from the mails by a fraudulent check-man who added the letters "hen" to the payee's name, changing it from Myrick Co. and making it read "Myrich Cohen." He then copied Mr. Moyer's signature by forging it and O.K.'d the endorsement of "Myrich Cohen"

and passed it without difficulty at the paying teller's window of the Mechanics and Metals National Bank.

BUSINESS STILL IN YOUTH

As we pointed out at the start, the surety company is in its early youth. The business is constantly growing and expanding and becoming stronger and stronger each year. The openings for the right kind of a man or woman are greater in the surety business than in any other similar line. The opportunities to meet and know men in all lines of business, the engaging and difficult underwriting problems which give abundant opportunity for the exercise of a keen business judgment, and the many complicated and absorbing situations that arise both before and after the giving of a bond, make the business most attractive. Its progress has been steady from the start, and this year it continues. The figures for our company are fairly indicative of the forward march of the business. The net premium income of the company ten years ago was two and one-half million dollars; five years ago it was three and one-half million, and last year over eight million dollars. The first four months of this year show a more than fifty per cent advance over last year. In this increase our agents and solicitors share, as they have shared in the work of production. One man on commission with the company is making more this year than many a bank president. There is every reason to believe that it has by no means reached the peak of its growth, but that, on the contrary, as the public continues to learn and appreciate the many valuable ways of using a surety bond, and those active in the business increase their experience in underwriting and in management, the business is bound to show a steady, healthy expansion for many years to come.

The Business

Principles

Principles

As outlined in a lecture before
School of Business, Columbia University

By

WILLIAM A. TIERNEY

Vice-President, National Society of Manufacturers

MSH 21901

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TITLE**